



## Update - Kingsway Proves Once Again It is Better to Give Than to Receive

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Last year we reported that a Pennsylvania state court (the “Court”) issued a decision dismissing the Pennsylvania Insurance Department’s (the “Department”) challenge to the highly-creative stock plan that Kingsway executed to distribute shares of its subsidiary Lincoln General Insurance Company (“Lincoln”). (See *Pennsylvania Insurance Department v. Kingsway Financial, Inc., et al.* 2010 WL 1236303 and “[Kingsway Proves Once Again It is Better to Give Than to Receive](#),” (Locke Lord Client Alert, April 5, 2010)). Kingsway recently announced a settlement with the Department in this matter. In addition, the Court’s decision has prompted the National Association of Insurance Commissioners (“NAIC”) to adopt changes to the NAIC Model Insurance Holding Company System Regulatory Act (“Model Act”) to close perceived loopholes in the Model Act and require prior approval for Kingsway-type transactions.

### Background

According to the court, in 2005, Lincoln began experiencing financial distress and a deteriorating financial condition, and in March 2009, Lincoln signed an agreement with the Department to “run-off” Lincoln’s book of business. Lincoln is a Pennsylvania domestic insurance company, owned by its sole shareholder Walshire Assurance Company (“Walshire”), a Pennsylvania corporation, which in turn is wholly-owned by Kingsway America, a Delaware Corporation. Kingsway, an insurance holding company incorporated in Ontario, Canada, is the parent company of Kingsway America.

After signing the run-off agreement, Lincoln began to review the adequacy of its reserves, but before Lincoln completed its review, Kingsway decided to divest its entire interest in Lincoln by donating 5 percent of Walshire’s stock (the “Stock”), plus \$20,000, to each of 20 charities. Kingsway reportedly contacted the charities on a Friday, inquiring whether they would be present the following Monday to accept a donation, without providing specifics regarding the donation. The following Monday, Kingsway’s officers visited the charities to hand over the donation of the money and the Stock. Upon receipt, a charity’s representative was required to sign a gift receipt and have a photograph taken with the Stock certificate to acknowledge receipt. After the gifts were made, Kingsway informed the Department of the transactions.

In October 2009, the Department sent a letter to Kingsway stating its belief that the transaction was illegal and also advised five of the charities known to have received the donation to return the Stock to Kingsway. At least one charity attempted to do so, but Kingsway refused to accept the Stock. On November 20, 2009, the Department filed a petition in Pennsylvania state court alleging that the transaction violated three provisions of the Pennsylvania Insurance Code.

In announcing its lawsuit, the Department called Kingsway’s actions “sham transactions for the sole purpose of evading its obligations under multiple provisions of insurance law designed to protect an



insurance subsidiary from being abandoned by its parent holding company.” Kingsway disputed this characterization, stating its view that the donation of the Stock to the charities was entirely legal. The Department sought a declaration from the Court that Kingsway’s divestiture of the Stock was illegal and an injunction to “unwind” the transaction as well as payment of certain expenses.

The Department alleged a violation of section 1402(a)(1) of the Pennsylvania Insurance Holding Companies Act (the “Act”), which prohibits a person from entering into an agreement to “acquire control” of a domestic insurer unless: 1) the person has filed with the Department and sent to the insurer a statement containing certain information (a “Form A”); and 2) the agreement or acquisition has been approved by the Department. By examining the plain language of the statute, the Court found there was no requirement to file a Form A as each charity acquired only 5 percent of the Stock, and the Department failed to demonstrate that any of the charities had *control* of Lincoln by virtue of their holding 5 percent of the Stock.

The Department also alleged that the transaction violated section 1405(a)(2) of the Act, which prohibits certain transactions “involving a domestic insurer and any person in its holding company system” unless: 1) the insurer has given prior written notice to the Department (a “Form D”); and 2) the Department has not disapproved it. The Court found the transaction involved 20 charities, none of which were in the holding company system, so this provision of the Holding Company Act was likewise inapplicable.

The Court then dismissed the Department’s lawsuit against Kingsway in April 2010.

### Settlement

Following the Department’s appeal of the Court’s decision to the Pennsylvania Supreme Court, the parties settled. Pursuant to the settlement between the Department and Kingsway reached in October 2011, Kingsway will reacquire 49 percent of Walshire in a joint venture with Tawa PLC and the parties will dismiss all claims against each other. Day-to-day management of Walshire and Lincoln General will be performed by Tawa, subject to the oversight of the companies’ boards of directors. Kingsway reported obtaining releases from Walshire, Lincoln and the 20 charities.

### NAIC Holding Company Act Revisions

The Court’s decision already had prompted the NAIC, in December 2010, to adopt changes to the Model Act to explicitly require “any controlling person of a domestic insurer seeking to divest its controlling interest in the domestic insurer, in any manner, [to] file with the commissioner, with a copy to the insurer, confidential notice of its proposed divestiture at least 30 days prior to the cessation of control.” The amendment further provides: “The commissioner shall determine those instances in which the party(ies) seeking to divest or to acquire a controlling interest in an insurer, will be required to file for and obtain approval of the transaction.” If the divestiture otherwise requires prior approval on a Form A, this requirement does not apply. Thus, under the revised Model Act, if a domestic insurer divests a controlling interest to a group, where no member acquires control, the applicable insurance department must be notified with opportunity to approve or disapprove the transaction. The revised Model Act will need to be adopted by individual state legislatures and insurance departments before it is effective in any particular state.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors:

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